Information from the Division of Health Care Finance and Policy

Quarterly Acute Hospital Financial Report, FY05 Q4

The financial health of the hospital industry showed significant improvement in FY05 Q4. Overall profitability improved substantially for the industry as a whole. Hospitals also demonstrated sustained improvements in liquidity, with nearly all hospitals comfortably able to meet short-term obligations. In addition, solvency improved for most of the industry; however, the ability to cover long-term obligations remains a serious concern for one-third of Massachusetts hospitals.

About this Report

The Division of Health Care Finance and Policy (the Division) publishes quarterly acute hospital financial reports in response to a legislative mandate to provide an annual assessment of financial trends in the acute care hospital industry. Quarterly reporting is one part of the Division's ongoing program to better protect the public interest by continuously monitoring the financial condition of acute care hospitals. This report presents an industry-wide analysis from FY01 through FY05 Quarter 4 (Q4).[1] Financial trends for individual hospitals are on each hospital's Fact Sheet in the DHCFP Data Catalog at www.mass.gov/dhcfp.

Trends in financial ratio analysis can provide useful information about the hospital industry's financial condition. The three areas examined on a quarterly basis are profitability, liquidity, and solvency.[2]

Profitability

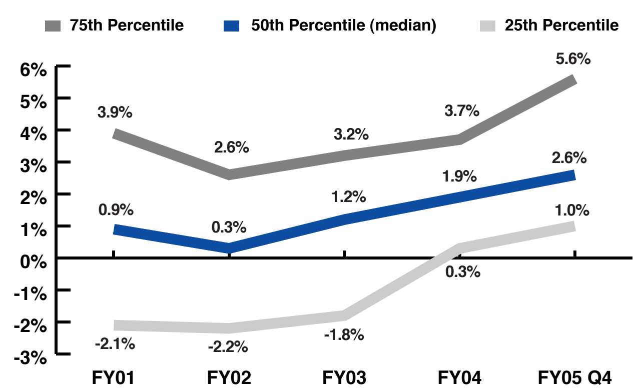
Although most Massachusetts acute care hospitals are nonprofit, they do need to generate a sufficient surplus in order to complete their missions, repay debt, and invest in the future of their organizations. Therefore, an analysis of the industry's profitability using three key ratios is reported here. Figures 1, 2, and 3 show FY01 through FY05 Q4 trends for 25th, 50th (median) and 75th quartile values[3] for Total Margin,[4] Operating Margin,[5] and Non-operating Margin.[6]

Total profitability improved significantly for all three quartiles in FY05 Q4 compared to FY04, with 86% of hospitals experiencing positive total margins (up from 79% in FY04), and only 14% experiencing a total loss (versus 21% in FY04). Operating Margins also improved across all quartiles, with 77% (versus 58% in FY04) reporting operating gains, and 23% (versus 42% in FY04) reporting operating losses. Non-operating Margins also improved in the middle and lower quartiles, with 95% of hospitals (versus 88% in FY04) experiencing non-operating gains, and only 5% (versus 12% in FY04) experiencing non-operating losses.

Liquidity

Liquidity ratios indicate a hospital's ability to meet its short-term obligations. Deterioration of these ratios is one indica-

Figure 1
Total Margin Trend, FY01-FY05 Q4



- **Overall profitability improved across all three quartiles in FY05 Q4, with 86% of hospitals experiencing total gains, and 14% experiencing total losses.**

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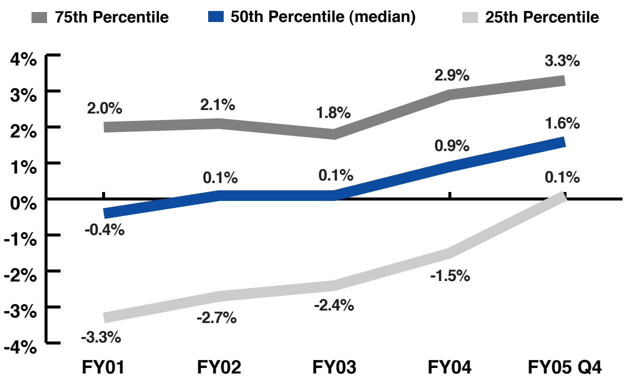
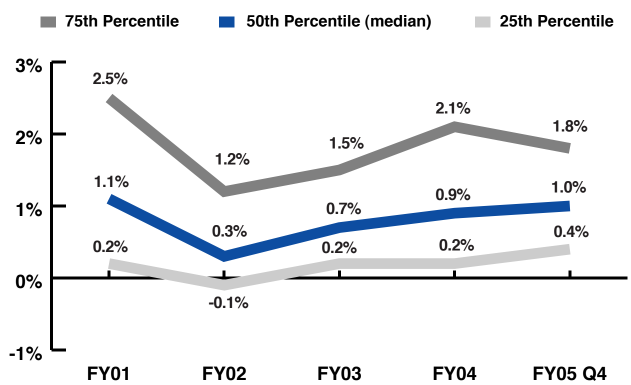
Figure 2
Operating Margin Trend, FY01-FY05 Q4



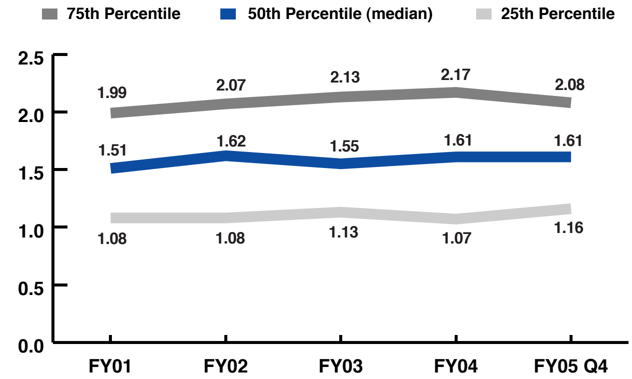
- **Operating performance continued to improve across the industry in FY05 Q4, with 77% of hospitals experiencing operating gains and 23% experiencing operating losses.**

Figure 3
Non-operating Margin Trend, FY01-FY05 Q4



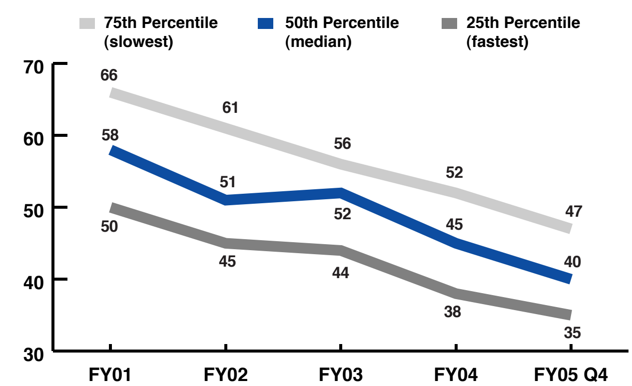
- **Non-operating Margin improved for the lower and middle quartiles in FY05 Q4, with 95% of hospitals experiencing non-operating gains and 5% experiencing non-operating losses.**

Figure 4
Current Ratio Trend, FY01-FY05 Q4



- **Current Ratio improved for the lower quartile, remained constant for the middle quartile, and decreased slightly for the upper quartile. A large majority of hospitals (82%) continued to maintain Current Ratios above the 1.0 benchmark in FY05 Q4.**

Figure 5
Days in Accounts Receivable Trend, FY01-FY05 Q4



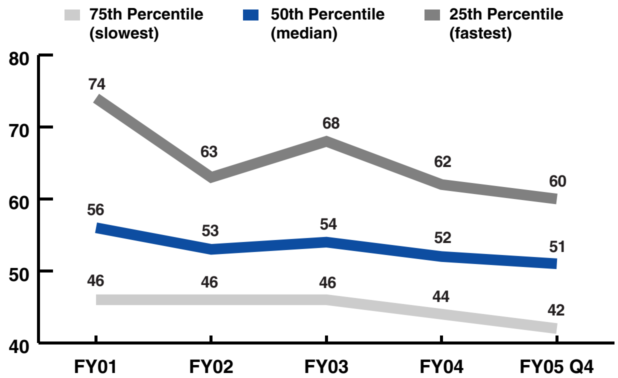
- **Continuing the industry's positive trend since FY01, hospitals again improved collection of receivables in FY05 Q4, with decreases across all three quartiles. Median Days in Accounts Receivable decreased by five days.**

tion of financial stress. Three liquidity ratios are reported here: Current Ratio,[7] Average Days in Accounts Receivable (A/R),[8] and Average Payment Period.[9] Figures 4, 5, and 6 show trends in quartile values for these three ratios.

The majority of hospitals demonstrated favorable short-term liquidity in FY05 Q4. The lower quartile showed improvement in Current Ratio. Although the middle quartile remained constant and there was a small decrease in the upper quartile, these values remained above the industry benchmark (see Figure 4).[10] In addition, the industry showed more efficient management of Days in A/R (see Figure 5) and improvement in the average time to pay current liabilities (Average Payment Period, see Figure 6) across all quartiles.

Figure 6

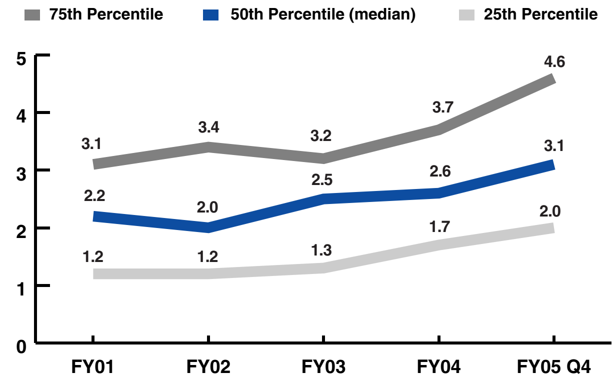
Average Payment Period Trend in Days, FY01-FY05 Q4



- **Average Payment Period decreased across all quartiles in FY05 Q4; however, 27% of hospitals paid current obligations at a faster rate than they collected receivables.**

Figure 7

Debt Service Coverage Total Trend, FY01-FY05 Q4



- **Debt Service Coverage improved across all quartiles. In addition, the percent of the industry facing potential difficulty covering interest and principle payments in the upcoming year dropped from 20% in FY04 to 10% in FY05 Q4.**

Solvency

Solvency ratios provide information regarding both how an organization finances its assets and how able an organization is to take on new debt. Deterioration of these ratios is another indication of problems in the financial health of an organization. For the fourth quarterly analysis, three solvency ratios are reported: Debt Service Coverage[11], Cash Flow to Total Debt[12], and Equity Financing.[13] Figures 7, 8, and 9 show trends in quartile values for these three ratios.

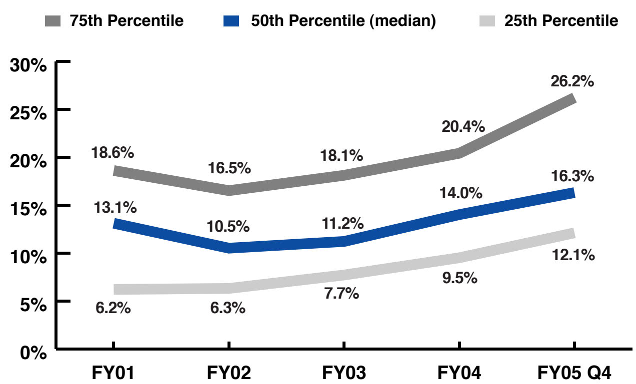
Debt Service Coverage, which measures the ability to meet principal and interest payments in the upcoming year, improved for the entire industry in FY05 Q4. All hospitals but one showed positive ratios, and all quartiles remained above the 1.5 benchmark. Further, only six hospitals exhibited Debt Service Coverage ratios below the 1.5 benchmark (see Figure 7).

Cash Flow to Total Debt is the measure of a hospital's percentage of cash flow to current and long term debt obligations and a known indicator of future financial distress and insolvency. This solvency indicator improved across all quartiles in FY05 Q4 versus FY04 (see Figure 8). Improvements were largely attributable to enhanced overall profitability for the industry.

The Equity Financing ratio, measured by the proportion of total assets financed by equity, reflects the ability of a hospital to take on more debt. Low values indicate that a hospital is highly leveraged, and therefore, may have difficulty securing access to debt financing for further asset acquisition. Equity Financing remained fairly constant in FY05 Q4 compared to FY04. A large proportion of the industry was above the 30% benchmark, and long term solvency remained favorable for this group; however, this ratio was below the 30% industry benchmark for the other 31% of the hospitals,

Figure 8

Cash Flow to Total Debt Trend, FY01-FY05 Q4



- **Cash Flow to Total Debt improved substantially across the industry in FY05 Q4. Improvements were largely due to enhanced profitability for the industry.**

indicating potential long-term solvency issues for this group (see Figure 9).

Teaching versus Non-teaching Hospitals

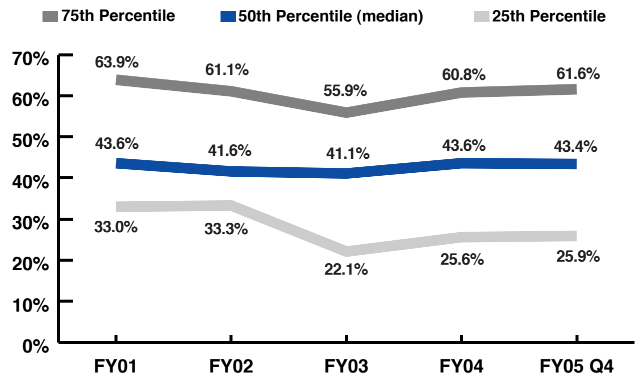
The Division of Health Care Finance and Policy also examines the financial health of teaching versus non-teaching hospitals using financial ratio analysis. Overall, teaching hospitals outperformed non-teaching hospitals in terms of profit levels; however, a slightly higher percentage of non-teaching hospitals (78%) versus teaching hospitals (73%) generated an operating surplus in FY05 Q4. In addition, a larger percentage of non-teaching hospitals (98%) versus teaching hospitals (87%) experienced non-operating gains. In terms of overall profitability, teaching hospitals fared better because many hospitals were able to offset operating losses with large non-operating gains. Overall, 93% of teaching hospitals generated total gains in FY05 Q4, versus 84% of non-teaching hospitals.

Results between the two groups were mixed with regard to liquidity. On average, Current Ratio was higher for teaching hospitals; however, a higher percentage (84%) of non-teaching hospitals had Current Ratios above the minimum industry benchmark of 1.0 (compared to 79% of teaching hospitals). In terms of collecting receivables due and paying current obligations, the results were mixed depending on the quartile.

In terms of solvency, teaching hospitals are generally stronger. A higher percentage of teaching hospitals—92% versus 82% for non-teaching hospitals—will have less difficulty meeting interest and principal payments in the upcoming year. With the exception of the upper quartile, teaching hospitals also performed better in terms of repaying current and non-current debt. Finally, teaching hospitals were substantially less leveraged as 79% (versus 66% of non-teaching hospitals) were above the 30% benchmark for Equity Financing.

Figure 9

Equity Financing Trend, FY01-FY05 Q4



- **Equity Financing Ratios remained fairly constant in FY05 Q4. However, just under one-third of the hospitals were below the 30% benchmark and the highly leveraged position of these hospitals may make future asset acquisition difficult for this group.**

Summary

The majority of hospitals reported improved overall profitability in FY05 Q4, with 86% experiencing total gains and only 14% of the industry experiencing total losses. Overall, the industry demonstrated improved liquidity, with nearly all hospitals comfortably able to meet short-term obligations. In addition, solvency improved for most of the industry; however, the ability to cover long-term obligations remains a serious concern for one-third of Massachusetts hospitals.

Financial ratios for each hospital are on the Hospital Fact Sheets in the DHCFP Data Catalog at www.mass.gov/dhcfp. Hospital-specific dollar surplus or loss, net patient service revenue, total net assets, and assets whose use is limited are also provided on the Fact Sheets illustrating the magnitude of hospital surplus and loss, the size of operation, and the size of reserves.

Endnotes

[1] The findings in this report are based on the financial filings of 65 acute care hospitals. One hospital–Children's Hospital Boston–did not submit its filing in time to be included in this report. Another hospital–Boston Medical Center–did not file a Balance Sheet or a Statement of Cash Flows. One hospital (Mercy Medical Center) has a fiscal year that ends on December 31, thus their most recent filing represents the first nine months rather than the 12 months of FY05. Due to the Vanguard purchase of MetroWest and Saint Vincent's hospitals, the fiscal year filings submitted represent six months of operation.

[2] Depending on the organization of each hospital, data may exclude other aspects of some hospitals' financial health, such as performance of endowments or the financial health of parent or other affiliated organizations.

[3] Quartile values can shed light on information about the distribution of financial ratio values across hospitals. Often, averages can be materially affected by outlier/extreme values at the low and high ends of a distribution. Examining quartiles, therefore, is a preferred means of assessing the overall distribution of values across hospitals. For instance, the ratio values of one-quarter of the hospitals at the low end of the distribution will fall at or below the 25th quartile value. Similarly, the ratio values of one-quarter of the hospitals at the high end of the distribution will fall at or above the 75th quartile value. The 50th percentile is the median, or the center of the distribution of values. Half of the hospitals' financial ratio values will fall below the median, and half will fall above the median. These quartile measures are particularly useful when a distribution is markedly skewed, or where it is generally symmetrical but includes a few outliers.

[4] Ratio of total income to total revenue.

[5] Ratio of operating income to total revenue.

[6] Ratio of non-operating income to total revenue.

[7] Ratio of current assets to current liabilities.

[8] Ratio of net patient accounts receivable to net patient service revenue/quarters of data * 91.25.

[9] Ratio of current liabilities less estimated third-party settlements to total expenses less depreciation and amortization/quarters of data * 91.25.

[10] A Current Ratio value of 1.0 indicates that a hospital has one dollar held in current assets per dollar of current liabilities. Values below 1.0 are considered strongly unfavorable and highlight an organization's illiquid position.

[11] Ratio of total income plus interest expense plus depreciation and amortization to interest expense plus current portion of long-term debt.

[12] Ratio of total income plus depreciation and amortization to total current liabilities plus total long-term debt.

[13] Ratio of total net assets to total assets.

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